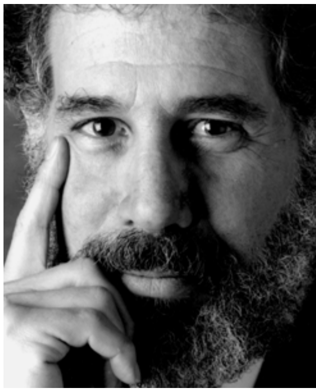

Leimberg's Think About It

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Life Insurance and Charitable Planning: A Guide to Success!

INTRODUCTION

The key to successfully integrating life insurance and charitable planning is finding the proper balance. But isn't that the problem in all of life? Isn't one of the most challenging of all human tasks to constantly find the proper balance?

What follows is a "no holds barred" look at why so few life insurance professionals successfully enter into the charitable market and why they fail once they get there as well as a discussion of what "works." The charitable arena can be a very lucrative market – in every sense (and dollar) of the term. But it's also one that demands a surprising (or to some, an astonishing) amount of technical knowledge – more than ordinary "people skills" – and demands a much higher level of ethics and responsibility.

FACE IT: THERE ARE PROBLEMS!

Whichever charity you choose, you will not be the first insurance professional to approach it. Every development director at almost any active charity can tell you a story about someone who has offered a life insurance "plan" that purports to do great – no, make that "incredible" – things for the charity. In all too many cases, the claims (whether explicit or implied) are: the plan "costs nothing," neither the charity nor the donor risks anything, and that there are few, if any, downsides.

Prudential

There has been an almost exponential growth in the number of such aggressive insurance programs being marketed to charities and few charities have not been approached with a charitable life insurance proposal during the last few years.

THE PROBLEM IS . . .

Too many charities already have been stung. Some have been hurt by overly optimistic charity-owned life insurance arrangements where premiums that were to have "vanished" never did. Instead, those supposed-to-have "vanished" premiums escalated to such embarrassing levels that the charity's relationship with the insured donor was strained or even seriously threatened. Some of these arrangements are so far "under water" that the charity has to use annual fund money to keep them "floating."

Worse yet, other charities are still smarting from outright "never could or never should work" schemes such as charitable split dollar and investor initiated and owned CHOLI (Charitable-Owned Life Insurance). These charity-related plans have incurred Congressional wrath and inspired legislation that either bars or severely discourages such arrangements – but not until much time and money was wasted and more than a few charities and donors were harmed.

Republican Senator Chuck Grassley and Democratic Senator Max Baucus stated of the investor initiated schemes that, "These arrangements do more to facilitate investment by private investors in life insurance than to further the charity's tax-exempt purposes," and that these are "snake oil salesman taking advantage of tax-exempt organizations to line their own pockets with life insurance schemes." Charitable split dollar and investor initiated charitable life insurance schemes violated the most important and fundamental principle in charitable planning: Charity is about giving – not taking!

PUT YOURSELF IN THE SHOES OF DEVELOPMENT OFFICERS

In order to work effectively with development officers, it is essential to put yourself in their place. When presented with an insurance proposal (any proposal for that matter), their task is to balance objectivity, efficiency, knowledge, uncommon common sense, open mindedness, courtesy, and sometimes a great deal of personal integrity and courage – and then decide whether to: (1) reject the proposal outright, (2) give it full, immediate, and serious consideration, or (3) table it until some appropriate time in the future.

One factor that will make a significant difference between your success and failure is the ability to see and solve the charity's problems through the eyes of the person you want to buy your idea.

So, let's suppose you are a development officer/planned giving director (or donor, fund raiser, charitable executive, or Board of Directors member) and someone has presented you with an insurance program that looks like a great way to benefit your organization.

Of course, you don't want to know or be bothered with a lot of tax law and technical gibberish. But you care and you know you must review the proposal and take appropriate action. You need to know the mistakes others (less concerned or well informed than you) have made and how to avoid them.

Since you are involved in the decision-making process, you also have an obligation to know the many positive and unique attributes of life insurance and how it can benefit your charity in ways that are simple, ethical, and easy to implement and manage. You need to know how life insurance can help your organization fulfill its charitable purposes to a degree that might otherwise not be possible.

CONCENTRATE ON CONCERNS AND FEARS

But you can't concentrate on the positive aspects of life insurance and what it can do for your charity until you eliminate or alleviate some of your fears.

What are your concerns about life insurance? Your first thoughts probably are:

- I don't have the staff, time, knowledge, energy, money or other resources to hire counsel/experts to investigate every life insurance scheme that comes along.
- I could spend all of my time analyzing these plans.
- No sooner have we investigated one arrangement than another comes along!

Then you might be thinking:

- Are we going to be betting against our donors' longevity?
- If we go along with this arrangement, are we risking our organization's reputation?

Or perhaps your concern is:

- Life insurance gifts are, by definition, delayed gifts! We are driven by annual gifts. We need the cash NOW!

You might also be worried that:

- I'm just not comfortable with life insurance; I don't know enough about it. It scares me. Or,
- We will not know if this program will "work" for many, many years.

Or possibly your big concern is that:

- If we do get involved, will this person be there for us? What happens if things don't go as we expect? Will this person be there to tell us what went wrong, why, or what our options are?

You may resist because:

- She is telling me this program would be great for our organization but it feels more like these promoters will be exploiting our relationship with our donors. This may not be in the best interest of our donors – and I can't endorse a program solely for our benefit without regard for a concern for our donors.

The final straw might be that:

- This just doesn't feel right! It may make money for us but, in reality, there is no charitable intent. It's just a tax or dollar juggling scheme and doesn't start and end with a donor who wants to make a positive difference!

WHAT SMART DEVELOPMENT OFFICERS WILL DEMAND:

There are three sine qua non-considerations that must be met before a charity should be willing to do business with you.

First, the prime motivation for the charitable contribution, no matter what form it takes, should be the donor's strong desire to support the work of the specific charitable institution involved.

Second, there should be complete disclosure to both the donor and the charity of every party's role and relationship in the transaction.

Third, all parties involved should act with fairness, honesty, integrity and openness and, except for fully disclosed fair and reasonable compensation for services you actually render, you should have no vested interest that could result in personal gain or cause a conflict of interest with either the donor or the charity.

In a nutshell, even before a charity's development officer begins to critically examine whether or not your proposal would "work," he or she should be asking:

- Is it likely and reasonable to expect that adopting the proposal will result in a positive net value to the charity and simultaneously assist the donors in achieving their charitable and personal objectives?

- Are the marketers and donors involved really trying to do something wonderful for our organization, or is their objective mainly to take something valuable and important from it?

- Is there true philanthropic intent? What does my instinct tell me?

QUESTIONS THE CHARITY SHOULD ASK YOU:

Here are some questions that the people representing the charity will (or should) ask you and everyone else who might be involved. There is no "right" order or "exact" number of questions but if most or all are asked and answered appropriately, the probability of a positive outcome and mutually profitable relationship will be significantly increased.

- How can we tell if what you are trying to sell us is legally legitimate, morally ethical, and economically viable?

- What's your background? Are you willing to provide us with references? What local charities have actually implemented this arrangement with you? How many of these plans have you set up and are operating now?

- Is a major and well-know insurer backing the proposal? Is that insurer willing to provide us with a letter assuring our organization that the tax and other representations you have made are accurate?

- What are the assumptions/variables that, if they do not work or fail to perform as planned or projected, could significantly and adversely impact on your proposal's outcome? What downsides, disadvantages, exposures are faced by our organization and our donor(s)?

- Will you provide us with a best/worst/probable range of rewards/costs? What is our maximum downside (or upside) if interest rates increase but mortality assumptions and the cost of insurance increase beyond expected and anticipated parameters? Do you have a back-up plan for us?

- What if we start this project and for some reason have to cut back or stop? Do you have a well-defined exit strategy and, if so, what's it going to cost (what fines, penalties, or other costs will we incur)?

- How long does the plan have to be in place for it to "work" (from our point of view)? What is our organizational risk-taking propensity, and does the proposal contain risks beyond our tolerance levels?

- What additional human resources effort and financial commitment will this require of our staff (initially and continually)?

- Do we have to sign a nondisclosure agreement? [An absolute "no-no".] Will there be potential adverse implications vis-à-vis securities, UBIT (Unrelated Business Income Tax), private benefit/private inurement, et cetera? Will our tax-exempt status be at risk if, in the implementation of this proposal, we provide inappropriate and obviously disproportionate benefits to an individual, investor group, or business?

- Do we have the requisite state law insurable interest on the persons insured?

- How dependent is the plan's success on an, as yet un-obtained, favorable interpretation of a combination of steps? What would be the impact on its success if Congress or a state legislature or a court were to change the specific law upon which the plan design is based?

- Are there restrictions on our organization's ability to discontinue paying premiums and/or divest our organization of the life insurance at some future date?

- Does a donor have to die for our organization to "profit"? Will we have to borrow money to finance insurance premiums? Even if we do not, how will the arrangement impact on our credit status? How will the transaction be shown on our books?

- Will someone other than our organization or its beneficiaries/clients profit under this arrangement? Aside from the pleasure of benefiting the charity and fulfilling his or her philanthropic objectives, what does the donor receive or expect to receive? Are the donor's expectations realistic, ethical and legal? From the donor's perspective, is this the best type of gift for him or her to be making?

- What debt instrument, contracts, or other legal instruments will we have to sign, and what is the maximum extent of our financial and other obligations under those documents? Do we have to provide any collateral or other guarantees? Is it possible for us to lose assets if we go through with this proposal?

- If the actual results fall short of the projections/assumptions made in your proposals, will additional premium payments be required from either our donors or us, or will the death benefit we've anticipated be reduced?

QUESTIONS THE CHARITY MUST ASK OF ITSELF

A wise charitable development officer will not only ask questions of you; he or she will ask many "internal" questions, such as:

- Does the proposal fit in with our organization's current cash flow, short and/or long-term needs? Can we afford to divert resources/money from current demands? Can we live with not knowing when we will receive the insurance proceeds? What portion of our investment portfolio – and long-term success – will be represented by this plan?

- Will our donors not make annual gifts, thinking that this "gift" (allowing the charity to benefit from their death) is their gift? Is the "donor" allowing the purchase of life insurance on his or her life – either by the charity or by a stranger investor group – in order to make what is perceived as a gift without spending his money or committing her time/energy? In other words, will the donor consider that, with little or no cost to him/her, "this could be my (only) gift?"

- What impact, if any, will the program have on attracting new (and true) donors and on the retention and encouragement of our current benefactors? Would there be any fallout if a donor insured finds he/she is restricted, limited or totally unable to purchase additional insurance for personal or business needs? What happens if a donor becomes involved in a financed life insurance arrangement with us, uses his own assets as collateral, and, for whatever reason, the arrangement does not perform as projected? What will be the impact on our relationship?

- How will our supporters react when they find out our organization has a vested interest in their premature death (i.e., we are betting against their longevity)? Are there ethical issues or negative perceptions? How would our supporters react when they discover that strangers will have a financial stake in their life expectancy (the shorter the better), and that, if they live too long, our organization will probably lose money or never collect what's expected? How will supporters feel when they find out that the investors will have the right to obtain confidential financial and health information on insured supporters – in some cases for the rest of their lives?

- Do we have a sufficiently competent staff and legal counsel (or can we cost effectively hire independent advisors) capable of performing a myriad of tasks in connection with the programs? For example, can they provide: a present value analysis of our expected outlays and compare them with the present value of our anticipated insurance proceeds in the future; or an objective comparative analysis of various policies and financial soundness, credit rating, and debt rating of the insurance company(ies) involved? Do we have (or can we obtain at a reasonable cost) legal counsel who can assure us that the program complies with applicable state insurable interest and other laws?

THE SUNNY SIDE OF LIFE

There is no question that life insurance is a powerful and positive charitable planning tool when used properly and in the right circumstances. Nationally known consumer advocate and insurance analyst JJ McNab, co-author of The Tools and Techniques of Charitable Planning, put it this way:

"These gifts can be quite profitable to a charity
who screens them carefully,
monitors them regularly and
makes smart decisions based on analysis rather than gut reaction."

ADVANTAGES OF LIFE INSURANCE

There are many reasons why life insurance could be considered the "Ultimate Endowing Tool":

1. A life insurance policy can provide a guaranteed death benefit. So, assuming premiums are paid, the charity's receipt of a given amount is certain. Compare this with an uncertain "I might leave it to you at my death" gift of real estate or marketable securities that may be subject to wide fluctuations in value.

2. If the insurance policy is given to, or originally owned by, a charity, the donor can't revoke the gift, assuming premiums are paid. So rather than a "maybe someday" gift that might never be made, charity-owned life insurance – particularly if it is a single premium or paid-up or soon to be paid-up contract – can be thought of as a "right here, right now" gift. One planned giving director said,

   "A paid-up or almost paid-up policy makes a wonderful gift –
   and, in fact, may be the best possible asset for a person to give us."

3. Life insurance provides an "amplified" gift because incredible leverage is possible. A relatively small amount of premium can translate into a large and meaningful gift. The leverage of premiums to insurance proceeds can be extremely favorable; perhaps many times more than the charity would otherwise receive from the same donor through a non-life insurance gift.

4. From a donor's perspective, life insurance can legitimately be considered a way to obtain "immortality on the installment plan." Almost anyone, regardless of economic station, can assure a meaningful and significant gift and, in most cases, a larger gift to charity through life insurance than by other methods. One development officer noted,

   "When a donor, who has been giving $5,000 annually to our charity, dies,
   we lose forever that $5,000, money which we have come to depend on.
   With a life insurance policy for just $100,000,
   the donor can endow the gift,
   the charity invests the $100,000 after the death of the donor,
   then spends only 5% of the capital each year,
   and the donor's gift and his/her memory live forever."

5. A life insurance gift is cost-efficient and provides "100 cent" dollars. Arranged properly, there is no "slippage" due to federal estate or state death taxes, state or federal income taxes, administration or estate settlement costs, or any other fees or charges.

6. Unlike other bequests, life insurance payable to a charitable beneficiary involves none of the costs, delay, or uncertainty of probate, or other administrative or legal issues.

7. The use of life insurance owned by and payable to a charity involves a negligible risk of contest. Because of the contractual nature of life insurance and the fact that it passes outside the insured's probate estate, there is only a scintilla of a chance the payment of life insurance could be successfully contested by disgruntled heirs. Nor can a surviving spouse intercept the policy proceeds payable to a charity. A spouse may elect against the decedent's will but it will not endanger a charity's claim to policy proceeds because they pass by contract to the charity.

8. The policy owner has the right to borrow against or use policy cash value as collateral as soon as it develops (within certain limits). If the charity is the owner of the policy, it has the same ownership rights as any other policy owner and can use policy values for any reason.

9. At the insured donor's discretion, life insurance can be publicity free or can provide "leveraged" honor. The size and even the existence of a life insurance gift can be completely confidential because of the contractual nature of life insurance. On the other hand, amplified recognition is possible if publicity is desired. For example, a special "key contributors" honor roll can be established to announce/acknowledge each contribution or purchase of a policy with a face amount (initial death benefit) of $1 million or more.

10. A life insurance gift to charity can be relatively "painless." From a (donor's) cash flow perspective, the gift of personally owned life insurance to charity is not typically perceived as the loss of "a needed asset" because no income-producing asset is being given away. From a wealth transfer perspective; a gift of life insurance to charity generally doesn't adversely affect the transfer of a family business, home, or investment portfolio that the heirs expect to receive.

11. The transfer itself is simple and cost efficient. Almost any size or type of policy can be used, although some are, of course, more preferable than others, and the insurer provides absolute assignment forms free of charge.

12. From the charity's perspective, there is much less administrative responsibility for an insurance policy than for real estate or other similar assets. Usually, there are no complex or expensive valuation procedures, nor is there concern about environmental problems. If the value of the policy is $5,000 or less, the insurer, typically at no charge, provides all the necessary information. Compare the cost, the degree of time and effort, and the simplicity of a gift of life insurance versus those in connection with charitable gifts of closely held stock, real estate, or interest in an LLC (limited liability company).

13. Annual premium statements (request duplicate premium notices), coupled with annual "thank you" notes, give the charity a continuing contact – and a yearly opportunity to

enhance its relationship – with the donor. It is very important that each annual premium be treated by the charity as a chance to renew and deepen the relationship and bond with its donor, and recognize again his or her generosity. Whenever possible, those directly benefited by the gift (e.g., scholarship recipients or department heads) should be introduced to the donor, perhaps giving the donor a "progress report" and a further chance to see how each annual premium is being used to help accomplish and sustain his or her philanthropic objectives.

WHAT WORKS REALLY WELL

One of the best ideas is to suggest that a charity consider and include a list of life insurance gift ideas in its fund-raising brochures rather than adopt a single formal program.

The major advantage is that, instead of having to participate in a single program, each donor/supporter can decide and choose the "planned giving" technique that is most suited to his or her particular circumstances in order to benefit the charity.

Here is a list of relatively low-risk, low-maintenance, high-return life insurance gift ideas:

The Two Percent Solution: Supporters can name the charity (provide them with the specific legal wording of its name) as the beneficiary of two to ten percent of existing or new insurance on their lives.

The "but if" Answer: The charity can be named as the secondary or tertiary (i.e., the "back up") beneficiary of donors' life insurance. This conditional "but if my spouse is not living, then to XYZ Charitable Organization" is particularly appealing and appropriate for married insureds who have no children/grandchildren or other close relatives to whom they want to leave their assets. It is almost always a very wise choice to name one or more charities as final/ultimate contingent beneficiaries of life insurance.

The Group Insurance "Income Tax Turnoff": Suggest to supporters who are still working that they name the charity as beneficiary of some (or preferably all) of their employer-sponsored group term life insurance. Point out that if a charity (or charities) is (are) named as the sole beneficiary(ies) during the entire tax year, the income tax that would otherwise be currently reportable on amounts in excess of $50,000 would not be taxable to them. So, without any current outlay, a supporter can assure a meaningful post-death gift to charity and perhaps save significant income taxes during his or her working years.

Gift of a Single Premium, Paid-Up, or Almost Paid-Up Contract: Donors and supporters may consider gifts of policies they no longer need and that will make little or no significant impact on their standard of living or lifestyle, or that of their heirs. An absolute assignment of an existing single premium or "paid-up" or almost paid-up policy to charity is an excellent gift requiring relatively minimal costs.

Name a Charity as the Beneficiary of a Term Rider: Let's suppose a client purchases a $1 million permanent policy for her family's protection. She might, at the same time, add a $200,000 term rider and name a charity as the beneficiary of the term rider. This is a simple and cost-effective strategy that can help maintain the insured donor's family's security and simultaneously provide a significant gift to one or more selected charities. The donor continues to own and control the policy ownership and its cash values as well as the right and flexibility to change, add, or even eliminate the charitable beneficiaries, if desired.

The Economic Shock Absorber: A charity can – and in many cases should – purchase insurance on the life of a major regular annual contributor, a particularly valued and financially helpful board member, or a key employee such as a president or other key executive officer in order to provide an "economic shock absorber" to the charity to compensate for the loss of income or gifts should the donor or board member die (prematurely), or to indemnify it for the loss of a key employee and the cost to find and hire his or her replacement. This is particularly appealing if the donor would be willing to donate an extra amount each year to cover some, or all, of the premium.

Contribution of a New or Existing Ongoing-Premium Policy: Typically, a charity is made the absolute owner and beneficiary, and holds all ownership rights. If the charity has an insurable interest under state law, the charity can be the original owner and beneficiary. Otherwise, the donor, or preferably the donor's spouse (if the insured is married and a single life policy is used), can purchase the policy and make an absolute assignment soon after the policy is issued (and put in force with minimal premium). If the insured's spouse purchases the policy, the insured never has any incidents of ownership and, consequently, there is never a question of estate tax inclusion. If a survivorship policy is used, then the younger and/or healthier spouse should be the initial owner. In this case, even if the initial owner were to die within three years of the gift, only the cash surrender value of the policy would be includible in his/her estate.

The downside of this gift strategy is that, in some cases, the charity has no absolute assurance the donor will continue to make contributions, and the policy may or may not be an appropriate investment for the charity to accept or continue to hold. But it can work well. The older the donor is, or the fewer premiums remaining to be paid, or the more cash value in the policy at the time of the gift, the more appropriate and beneficial the gift is and the more likely the gift is to be accepted. Very short-term-pay policies work best. And, in some cases, the donated policy cash values and/or dividends will be considerable; enough to maintain the policy in force even if the donor, for whatever reason, no longer contributes the funds to pay premiums.

Some long-time and loyal donors (myself included) have made contributions of ongoing-premium policies and have continued year after year to pay premiums. Experience will vary and here, as in any other part of planned giving, one of the most important factors of long-term success is the willingness and ability of the charity's staff to get to know the donor-insured after the gift and continually get to know that person even better in future years. It should come as no surprise that both donors who are continually informed and involved in the mission of the charity and the development officers/planned giving directors who continually involve their donors will find that life insurance can play an important part in the financial strength of their organizations in the long run.

CONCLUSION

There are, of course, many other ways life insurance can be used to enhance the financial strength of a charitable organization. Objectivity, enhanced knowledge, uncommon common sense, open-mindedness, and a healthy dash of personal integrity and courage are the basic ingredients that help smart charitable development officers/planned giving directors identify and distinguish between proposals that are pure alchemy and those that are true gold and make the right decision on how to maintain the balance.

As a life insurance professional, you need to understand those who are closely involved in the decision-making process: what they are, and should be, thinking; what they need to know/learn from you; and what they need to ask of themselves. Given your knowledge and skills, and the insight you gain from working with them, you can better anticipate their questions and give them sound and accurate answers – before they are asked.

Life insurance can help a charity fulfill its charitable purposes to a degree that might otherwise not be possible – but only if it is used wisely – and only if it is provided through a professional willing to take the time and make the effort to learn some very complex federal and state charitable tax and other law and who is willing to anticipate the problems from the viewpoint of development officers/planned giving directors.